

General Information Letter: If no federal income tax withholding is required for direct sellers pursuant to IRC Section 3508, no Illinois income tax withholding is required.

June 25, 2003

Dear:

This is in response to your correspondence to Paul Caselton dated May 20, 2003, in which you request a Letter Ruling. Department of Revenue ("Department") regulations require that the Department issue only two types of letter rulings, Private Letter Rulings ("PLRs") and General Information Letters ("GILs"). PLRs are issued by the Department in response to specific taxpayer inquiries concerning the application of a tax statute or rule to a particular fact situation. A PLR is binding on the Department, but only as to the taxpayer who is the subject of the request for ruling and only to the extent the facts recited in the PLR are correct and complete. GILs do not constitute statements of agency policy that apply, interpret or prescribe the tax laws and are not binding on the Department. For your general information, the regulation governing the issuance of letter rulings, 2 Ill. Adm. Code Part 1200 regarding rulings and other information issued by the Department, can be accessed at the Department's website. That address is [www.revenue.state.il.us/legalinformation/regs/part1200](http://www.revenue.state.il.us/legalinformation/regs/part1200).

In fact, your correspondence specifically requests a GIL. Therein you state in part as follows:

Attached is a request for a General Information Letter regarding Illinois' treatment of 'Direct Sellers' under Internal Revenue Code Sec. 3508 for payroll withholding requirements. This request is being submitted by COMPANY1 on behalf of our client, COMPANY2. Our ruling request sets forth the activities performed by COMPANY2 and their direct sellers as they currently operate.

### **Ruling Request**

This memo is a request from our client, COMPANY2, for a ruling regarding the State of Illinois' treatment related to COMPANY2's state payroll withholding filing requirements related to their contracted direct sellers. COMPANY2 is located at STREET, CITY, STATE ZIP CODE. Our Issues and Facts are outlined below:

### **Issues:**

The issues raised by the facts described in greater detail below are:

- 1.) If the direct sellers are not considered employees under Internal Revenue Code §3508, and similarly COMPANY2 would not be considered the direct sellers' employer and therefore would not be subject to Federal wage withholding or FICA reporting requirements, would COMPANY2 similarly not be subject to Illinois' wage withholding reporting requirements?
- 2.) If the answer to question #1 is that COMPANY2 would be subject to Illinois' wage withholding reporting requirements, please describe how COMPANY2 is to comply with Illinois' wage withholding reporting requirements since there will be no US federal payroll reports filed (e.g. W-2)?

### **Facts:**

*Activities Performed by COMPANY2 and their Direct Sellers*

COMPANY2 is involved in the direct marketing of consumer products or services through the sale of promotional discount certificates. The certificates are sold on behalf of the ultimate supplier of the goods or services. The certificates entitle holder (purchaser) to obtain products or services from the ultimate supplier at a discounted price. For example, the certificate contains coupons for discounted car washes, oil changes, two-for-one meals at restaurants and other discounted products and services.

Individuals acting as direct sellers on behalf of COMPANY2 will sell the promotional discount certificates. COMPANY2 refers to the direct sellers as "Sales Associates." COMPANY2 obtains the certificates from an independent third party promotion coordination business, which in turn has contracted with the ultimate provider of the consumer good or service to promote their product/service offerings. COMPANY2 provides such certificates to the Sales Associates. The Sales Associates sell such certificates to individual consumers on a door-to-door basis, either at the consumer's home or at the consumer's workplace. The Sales Associates obtain payment at the point of sale from the consumer and remits the proceeds to COMPANY2. The only remuneration by COMPANY2 to the Sales Associates is based on the commission earned by the given Sales Associate on each sale that he or she makes. Remuneration of the Sales Associates is not related to the number of hours worked. In no event is the solicitation by the Sales Associates conducted at or from permanent retail establishment. The Sales Associates provide no services to the consumers buying the promotional discount certificates.

The individual consumers redeem the promotional discount certificates for tangible products or services, often at the location of the ultimate provider of the consumer product or service. In all cases, the product (e.g., pizza or tires) or services (e.g., car wash) marketed through the promotional discount certificates are for the individual consumer's consumption or use.

The direct selling activities rendered by the Sales Associates are pursuant to a written contract between the individual Sales Associate and COMPANY2. This contract stipulates that the Sales Associate is paid purely on a commission basis based on the amount of sales, and that no deduction for taxes is (sic) to be made from such commission payments. The contract specifies that, pursuant to Internal Revenue Code § 3508, the Sales Associate will not be treated as an employee with respect to his or her services as a direct seller for US Federal and State tax purposes.

*Federal Tax Treatment*

Based on the description of the activities of direct sellers above, the individuals performing those services are not treated as employees for US federal purposes under Internal Revenue Code § 3508. Since COMPANY2 is not considered the employer of the Sales Associate under federal tax law, it will not be subject to US federal wage withholding, FICA and federal unemployment tax payment and reporting requirements. Therefore, these direct sellers will be issued a Federal Form 1099 annually to report the remuneration paid to them for their direct selling activities.

*Compliance Issues*

If Illinois will not follow US federal treatment described above related to Direct Sellers, logistical issues would arise from a state compliance point of view. For example, if COMPANY2 is not required to file federal annual wage statements (IRS Forms W-2 and related transmittal forms) or periodic payroll tax and withholding reports (IRS Forms 941), there will be no reports that would correspond with the state withholding reports. We are requesting guidance regarding the withholding and payment of Illinois' payroll related taxes and the preparation of Illinois state withholding tax reports, if they are required.

Please be advised that regulations promulgated pursuant to Ill. Inc. Tax Act §701 explicate the rules regarding the requirement to withhold Illinois Income tax. Particularly, 86 Ill. Adm. Code 100.7000 states

- a) General rules. Every employer maintaining an office or transacting business within this State **and required under the provisions of 26 USC 3401 through 3404 to withhold and pay federal income tax on compensation paid in this State** (see Section 100.7010 of this Part) to an individual is required to deduct and withhold from such compensation for each payroll period (as defined in 26 USC 3401), an amount computed in accordance with IITA Section 701 and 702. Illinois income tax is not required to be withheld on any compensation paid in this State of a character which is not subject to federal income tax withholding...

This is in accord with Illinois Income Tax Act Section 701(a), which provides that federal tax be required to be withheld before Illinois income tax must be withheld from the same compensation. Therefore, based on your representation that no federal income tax withholding required regarding the remuneration in question, Illinois income tax withholding is likewise also not required.

As stated above, this is a GIL which does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you wish to obtain a PLR which will bind the Department with respect to the application of the law to specific facts, please submit a request conforming to the requirements of 2 Ill. Adm. Code Part 1200.

Sincerely yours,

Jackson E. Donley,  
Senior Counsel-Income Tax